No. 70-82

In the Supreme Court of the United States

OCTOBER TERM, 1971

UNITED STATES OF AMERICA, APPELLANT
v.
TOPCO ASSOCIATES, INC.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS

REPLY BRIEF FOR THE UNITED STATES

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REPLY BRIEF FOR THE UNITED STATES

Two arguments advanced by appellee to justify the territorial division aspects of Topco's operations require a brief reply.

1. Appellee suggests that this case turns on the licensing of trademarks (Appellee's Brief, pp. 1, 36, 37) and that its territorial restrictions are incidental to the licensing of Topco trademarks in specified territories. This case, however, concerns restraints on the sale of products, not limitations on the use of trademarks. The restrictions imposed by Topco on its members forbid them from reselling outside of their assigned territories products bearing Topco brands which have

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been sold to the members and which they own outright.

Whatever right the owner of a trademark may have unilaterally to franchise others to use the mark in specified territories, once the trademarked article is sold and placed in the channels of commerce, no trademark restriction can lawfully limit the right of the purchaser of that product to sell it at whatever price, to whatever customer, in whatever place he wishes. See, *e.g., United States* v. *Bausch & Lomb Co.,* 321 U.S. 707, 721; *Dr. Miles Medical Co.* v. *Parks & Sons Co.,* 220 U.S. 373, 404; cf. *United States* v *Univis Lens Co.,* 316 U.S. 241, 250. Thus the trademark on its bicycle did not permit the Schwinn Company to specify the territory in which its retailers and distributors could sell bicycles which they had purchased from it. *United States* v. *Arnold, Schwinn & Co.,* 388 U.S. 365, 375, 376. Moreover, agreements among actual or potential competitors who use trademarks to allocate territories are illegal *per se* under the Sherman Act. *Timken Roller Bearing Co.* v. *United States,* 341 U.S. 593; *United States* v. *Holophane Co.,* 119 F. Supp. 114 (D. Ohio), affirmed *per curiam,* 352 U.S. 903; cf. *United States* v. *Sealy, Inc.,* 388 U.S. 350.

2. Appellee urges that its horizontal territorial restrictions should be permitted because, if its member-owners can eliminate competition with each other, they can then compete more effectively with vertically integrated retailers such as A&P, Safeway and Kroger. Appellee thus concedes that the purpose of

its territorial restriction is to protect its members from their own competition. Indeed, defense witnesses uniformly testified that this was the purpose of the restriction, and that it was intended to give Topco members exclusive power, in their territories, over the pricing and merchandising of Topco products. (See *e.g.,* A. 56, 72, 178, 184–190, 242, 317, 352.)

But the antitrust laws have never sanctioned horizontal restraints among competitors as a means of equalizing the advantages enjoyed by larger rivals. "In such a case there is no measure of what is necessary to the protection of either party, except the vague and varying opinion of judges as to how much, on principles of political economy, men ought to be allowed to restrain competition." Taft, J., in *United States* v. *Addyston Pipe & Steel Co.*, 85 Fed. 271 282–283 (C.A. 6). The theory of the Sherman Act is that the free forces of the marketplace, not agreements among competitors, are to determine the allocation of business.

To make the legality of anticompetitive conduct under the Sherman Act turn upon a weighing of the evils resulting from that conduct against the alleged benefits resulting from the combining competitors' ability to direct their economic power more effectively against their rivals would require the courts to enter into protracted investigations in an attempt to determine what constitutes "adequate" competition in a particular industry. This type of analysis has proved to be one of the most difficult tasks that the regulatory agencies have to perform, even though they have

the aid of carefully elaborated legislative criteria and large economic staffs. The courts wisely have declined to embark upon such investigations.

Thus, in *United States* v. *Arnold, Schwinn & Co., supra*, the Court recently rejected the contention that a bicycle manufacturer was justified in limiting the persons to whom its retail outlets could sell because the restriction enabled the manufacturer and its retailers better to compete with large mass merchandisers, such as Sears and Montgomery Ward. The Court ruled (388 U.S. at 375):

> [T]his argument, appealing as it is, is not enough to avoid the Sherman Act proscription; because, in a sense, every restrictive practice is designed to augment the profit and competitive position of its participants. Price fixing does so, for example, and so may a well-calculated division of territories. See *United States* v. *Socony-Vacuum Oil Co.,* 310 U.S. 150 (1940). The antitrust outcome does not turn merely on the presence of sound business reason or motive. * * *

See also *United States* v. *Addyston Pipe, supra*, 85 Fed. at 282–284; *United States* v. *Philadelhpia National Bank*, 374 U.S. 321, 370.

Indeed, if it is permissible to justify territorial divisions because they allegedly help smaller firms in competing with larger ones, it would appear equally appropriate to apply a similar form of justification to other anticompetitive practices that have long been condemned as illegal *per se,* such as price-fixing. The entire history of antitrust enforcement in this country

has been to the contrary, however. Rather than permitting justification of *per se* practices because of countervailing benefits, this Court has recognized that these practices have such a pernicious anticompetitive effect that they properly may be condemned out of hand without an elaborate inquiry into the nature of the industry and the effect of the practices upon competition therein. See *Northern Pacific Railway Co.* v. *United States*, 356 U.S. 1, 5.

The dangers of permitting competitors to divide markets as a means of counterbalancing the strength of other, larger competitors are manifest. In retail distribution, a single firm that has the advantages of a collective buying organization like Topco can match in local markets the power of its large integrated rivals. The resulting economies will largely be passed on to consumers if such firms operate in competitively structured, open markets in which each independent firm is required to strive against every other retailer in every aspect of its retail sales.

But when confederated firms guarantee themselves against territorial competition with each other, a local structure tends to develop in which a few large integrated firms and a few firms backed by the equalizing weight of their buying organization dominate the market, to the detriment of their smaller competitors. As a result, all of the disadvantages for consumers which attend retail oligopoly will appear (see *United States* v. *Alcoa,* 377 U.S. 271, 280; Bain, *Industrial Organization,* (2d ed.) 28–31, 112–162, 306–332; Stigler, *The Organization of Industry,* ch. 5).

CONCLUSION

For the reasons stated in this reply brief and in the government's main brief, the judgment of the district court should be reversed.

Respectfully submitted.

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UNITED STATES v. TOPCO ASSOCIATES, INC.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE NORTHERN DISTRICT OF ILLINOIS

No. 70-82. Argued November 16, 1971—Decided March 29, 1972

The United States brought this injunction action charging a violation of § 1 of the Sherman Act by appellee, Topco, a cooperative association of about 25 small and medium-sized independent regional supermarket chains operating in 33 States. As its members' purchasing agent appellee procures more than 1,000 different items, most of which have brand names owned by Topco. The members' combined retail sales in 1967 were $2.3 billion, exceeded by only three national grocery chains. A member's average market share in its area is about 6% and its competitive position is frequently as strong as that of any other chain. The members own equal amounts of Topco's common stock (the voting stock), choose its directors, and completely control the association's operations. Topco's bylaws establish an "exclusive" category of territorial licenses, under which most members' licenses are issued and the two other membership categories have proved to be *de facto* exclusive. Since no member under this system may sell Topco-brand products outside the territory in which it is licensed, expansion into another member's territory is in practice permitted only with the other member's consent, and since a member in effect has a veto power over admission of a new member, members can control actual or potential competition in the territorial areas in which they are concerned. Topco members are prohibited from selling any products supplied by the association at wholesale, whether trademarked or not, without securing special permission, which is not granted without the consent of other interested licensees (usually retailers) and then the member must agree to restrict Topco product sales to a specific area and under certain conditions. The Government charged that Topco's scheme of dividing markets violates the Sherman Act because it operates to prohibit competition in Topco-brand products among retail grocery chains, and also challenged Topco's restrictions on wholesaling. Topco contended that it needs territorial divisions to maintain its private-label program and to enable it to compete with the larger chains; that the association could not exist if the territorial divisions were not exclusive; and that the restrictions on competition in Topco-brand sales enable members to meet larger chain competition.

The District Court, agreeing with Topco, upheld the restrictive practices as reasonable and pro-competitive. *Held:* The Topco scheme of allocating territories to minimize competition at the retail level is a horizontal restraint constituting a *per se* violation of § 1 of the Sherman Act, and the District Court erred in applying a rule of reason to the restrictive practices here involved. *United States* v. *Sealy, Inc.*, 388 U. S. 350. Topco's limitations upon reselling at wholesale are for the same reason *per se* invalid under § 1. Pp. 606-612.

319 F. Supp. 1031, reversed and remanded.

MARSHALL, J., delivered the opinion of the Court, in which DOUGLAS, BRENNAN, STEWART, and WHITE, JJ., joined. BLACKMUN, J., filed an opinion concurring in the result, *post*, p. 612. BURGER, C. J., filed a dissenting opinion, *post*, p. 613. POWELL and REHNQUIST, JJ., took no part in the consideration or decision of the case.

Howard E. Shapiro argued the cause for the United States. With him on the briefs were *Solicitor General Griswold* and *Deputy Assistant Attorney General Comegys.*

Victor E. Grimm argued the cause for appellee. With him on the brief were *John T. Loughlin* and *William R. Carney.*

MR. JUSTICE MARSHALL delivered the opinion of the Court.

The United States brought this action for injunctive relief against Topco Associates, Inc.'s (Topco) alleged violation of § 1 of the Sherman Act, 26 Stat. 209, as amended, 15 U. S. C. § 1. Jurisdiction was grounded in § 4 of the Act, 15 U. S. C. § 4. Following a trial on the merits, the United States District Court for the Northern District of Illinois entered judgment for Topco, 319 F. Supp. 1031, and the United States appealed directly to this Court pursuant to § 2 of the Expediting Act, 32 Stat. 823, as amended, 15 U. S. C. § 29. We noted probable jurisdiction, 402 U. S. 905 (1971), and we now reverse the judgment of the District Court.

I

Topco is a cooperative association of approximately 25 small and medium-sized regional supermarket chains which operate stores in some 33 States.[1] Each of the member chains operates independently; there is no pooling of earnings, profits, capital, management, or advertising resources. No grocery business is conducted under the Topco name. Its basic function is to serve as a purchasing agent for its members.[2] In this capacity, it procures and distributes to the members more than 1,000 different food and related nonfood items, most of which are distributed under brand names owned by Topco. The association does not itself own any manufacturing, processing, or warehousing facilities, and the items that it procures for members are usually shipped directly from the packer or manufacturer to the members. Payment is made either to Topco or directly to the manufacturer at a cost that is virtually the same for the members as for Topco itself.

All of the stock in Topco is owned by the members, with the common stock, the only stock having voting rights, being equally distributed. The board of directors, which controls the operation of the association, is drawn from the members and is normally composed of high-ranking executive officers of member chains. It is the board that elects the association's officers and ap-

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[1] Topco, which is referred to at times in this opinion as the "association," is actually composed of 23 chains of supermarket retailers and two retailer-owned cooperative wholesalers.

[2] In addition to purchasing various items for its members, Topco performs other related functions: *e. g.*, it insures that there is adequate quality control on the products that it purchases; it assists members in developing specifications on certain types of products (*e. g.*, equipment and supplies); and it also aids the members in purchasing goods through other sources.

points committee members, and it is from the board that the principal executive officers of Topco must be drawn. Restrictions on the alienation of stock and the procedure for selecting all important officials of the association from within the ranks of its members give the members complete and unfettered control over the operations of the association.

Topco was founded in the 1940's by a group of small, local grocery chains, independently owned and operated, which desired to cooperate to obtain high quality merchandise under private labels in order to compete more effectively with larger national and regional chains.[3] With a line of canned, dairy, and other products, the

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[3] The founding members of Topco were having difficulty competing with larger chains. This difficulty was attributable in some degree to the fact that the larger chains were capable of developing their own private-label programs.

Private-label products differ from other brand-name products in that they are sold at a limited number of easily ascertainable stores. A&P, for example, was a pioneer in developing a series of products that were sold under an A&P label and that were only available in A&P stores. It is obvious that by using private-label products, a chain can achieve significant cost economies in purchasing, transportation, warehousing, promotion, and advertising. These economies may afford the chain opportunities for offering private-label products at lower prices than other brand-name products. This, in turn, provides many advantages of which some of the more important are: a store can offer national-brand products at the same price as other stores, while simultaneously offering a desirable, lower priced alternative; or, if the profit margin is sufficiently high on private-brand goods, national-brand products may be sold at reduced price. Other advantages include: enabling a chain to bargain more favorably with national-brand manufacturers by creating a broader supply base of manufacturers, thereby decreasing dependence on a few, large national-brand manufacturers; enabling a chain to create a "price-mix" whereby prices on special items can be lowered to attract customers while profits are maintained on other items; and creation of general goodwill by offering lower priced, higher quality goods.

association began. It added frozen foods in 1950, fresh produce in 1958, more general merchandise equipment and supplies in 1960, and a branded bacon and carcass beef selection program in 1966. By 1964, Topco's members had combined retail sales of more than $2 billion; by 1967, their sales totaled more than $2.3 billion, a figure exceeded by only three national grocery chains.[4]

Members of the association vary in the degree of market share that they possess in their respective areas. The range is from 1.5% to 16%, with the average being approximately 6%. While it is difficult to compare these figures with the market shares of larger regional and national chains because of the absence in the record of accurate statistics for these chains, there is much evidence in the record that Topco members are frequently in as strong a competitive position in their respective areas as any other chain. The strength of this competitive position is due, in some measure, to the success of Topco-brand products. Although only 10% of the total goods sold by Topco members bear the association's brand names, the profit on these goods is substantial and their very existence has improved the competitive potential of Topco members with respect to other large and powerful chains.

It is apparent that from meager beginnings approximately a quarter of a century ago, Topco has developed into a purchasing association wholly owned and operated by member chains, which possess much economic muscle, individually as well as cooperatively.

II

Section 1 of the Sherman Act provides, in relevant part:

> "Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of

[4] The three largest chains are A&P, Safeway, and Kroger.

trade or commerce among the several States, or with foreign nations, is declared to be illegal . . . ."

The United States charged that, beginning at least as early as 1960 and continuing up to the time that the complaint was filed, Topco had combined and conspired with its members to violate § 1 [8] in two respects. First, the Government alleged that there existed:

"a continuing agreement, understanding and concert of action among the co-conspirator member firms acting through Topco, the substantial terms of which have been and are that each co-conspirator member firm will sell Topco-controlled brands only within the marketing territory allocated to it, and will refrain from selling Topco-controlled brands outside such marketing territory."

The division of marketing territories to which the complaint refers consists of a number of practices by the association.

Article IX, § 2, of the Topco bylaws establishes three categories of territorial licenses that members may secure from the association:

"(a) *Exclusive*—An exclusive territory is one in which the member is licensed to sell all products bearing specified trademarks of the Association, to the exclusion of all other persons.

"(b) *Non-exclusive*—A non-exclusive territory is one in which a member is licensed to sell all products bearing specified trademarks of the Association, but not to the exclusion of others who may also be licensed to sell products bearing the same trademarks of the Association in the same territory.

"(c) *Coextensive*—A coextensive territory is one

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[8] Topco was named in the complaint as the sole defendant, but the complaint clearly charged that its members, while not defendants, were coconspirators in Topco's violation of the Sherman Act.

> in which two (2) or more members are licensed to sell all products bearing specified trademarks of the Association to the exclusion of all other persons. . . ."

When applying for membership, a chain must designate the type of license that it desires. Membership must first be approved by the board of directors, and thereafter by an affirmative vote of 75% of the association's members. If, however, the member whose operations are closest to those of the applicant, or any member whose operations are located within 100 miles of the applicant, votes against approval, an affirmative vote of 85% of the members is required for approval. Bylaws, Art. I, § 5. Because, as indicated by the record, members cooperate in accommodating each other's wishes, the procedure for approval provides, in essence, that members have a veto of sorts over actual or potential competition in the territorial areas in which they are concerned.

Following approval, each new member signs an agreement with Topco designating the territory in which that member may sell Topco-brand products. No member may sell these products outside the territory in which it is licensed. Most licenses are exclusive, and even those denominated "coextensive" or "non-exclusive" prove to be *de facto* exclusive. Exclusive territorial areas are often allocated to members who do no actual business in those areas on the theory that they may wish to expand at some indefinite future time and that expansion would likely be in the direction of the allocated territory. When combined with each member's veto power over new members, provisions for exclusivity work effectively to insulate members from competition in Topco-brand goods. Should a member violate his license agreement and sell in areas other than those in which he is licensed, its membership can be terminated under Art. IV, §§ 2 (a) and 2 (b) of the

bylaws. Once a territory is classified as exclusive, either formally or *de facto*, it is extremely unlikely that the classification will ever be changed. See Bylaws, Art. IX.

The Government maintains that this scheme of dividing markets violates the Sherman Act because it operates to prohibit competition in Topco-brand products among grocery chains engaged in retail operations. The Government also makes a subsidiary challenge to Topco's practices regarding licensing members to sell at wholesale. Under the bylaws, members are not permitted to sell any products supplied by the association at wholesale, whether trademarked or not, without first applying for and receiving special permission from the association to do so.[6] Before permission is granted, other licensees (usually retailers), whose interests may potentially be affected by wholesale operations, are consulted as to their wishes in the matter. If permission is obtained, the member must agree to restrict

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[6] Article IX, § 8, of the bylaws provides, in relevant part:

"Unless a member's membership and licensing agreement provides that such member may sell at wholesale, a member may not wholesale products supplied by the Association. If a membership and licensing agreement permits a member to sell at wholesale, such member shall control the resale of products bearing trademarks of the Association so that such sales are confined to the territories granted to the member, and the method of selling shall conform in all respects with the Association's policies."

Shortly before trial, Topco amended this bylaw with an addition that permitted any member to wholesale in the exclusive territories in which it retailed. But, the restriction remained the same in all other cases.

It is apparent that this bylaw on its face applies whether or not the products sold are trademarked by Topco. Despite the fact that Topco's general manager testified at trial that, in practice, the restriction is confined to Topco-branded products, the District Court found that the bylaw is applied as written. We find nothing clearly erroneous in this finding. Assuming, *arguendo*, however, that the restriction is confined to products trademarked by Topco, the result in this case would not change.

the sale of Topco products to a specific geographic area and to sell under any conditions imposed by the association. Permission to wholesale has often been sought by members only to be denied by the association. The Government contends that this amounts not only to a territorial restriction violative of the Sherman Act, but also to a restriction on customers that in itself is violative of the Act.[7]

From the inception of this lawsuit, Topco accepted as true most of the Government's allegations regarding territorial divisions and restrictions on wholesaling, although it differed greatly with the Government on the conclusions, both factual and legal, to be drawn from these facts.

Topco's answer to the complaint is illustrative of its posture in the District Court and before this Court:

> "Private label merchandising is a way of economic life in the food retailing industry, and exclusivity is the essence of a private label program; without exclusivity, a private label would not be private. Each national and large regional chain has its own exclusive private label products in addition to the nationally advertised brands which all chains sell. Each such chain relies upon the exclusivity of its own private label line to differentiate its private

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[7] When the Government first raised this point in the District Court, Topco objected on the ground that it was at variance with the charge in the complaint. The District Court apparently agreed with Topco that the complaint did not cover customer limitations, but permitted the Government to pursue this line on the basis that if the limitations were proved, the complaint could later be amended. App. 141. Topco acquiesced in this procedure, and both sides dealt with customer limitations in examining witnesses. The District Court made specific findings and conclusions with respect to the totality of the restraints on wholesaling. In light of these facts, the additional fact that the complaint was never formally amended should not bar our consideration of the issue.

label products from those of its competitors and to attract and retain the repeat business and loyalty of consumers. Smaller retail grocery stores and chains are unable to compete effectively with the national and large regional chains without also offering their own exclusive private label products.

. . . . .

"The only feasible method by which Topco can procure private label products and assure the exclusivity thereof is through trademark licenses specifying the territory in which each member may sell such trademarked products." Answer, App. 11.

Topco essentially maintains that it needs territorial divisions to compete with larger chains; that the association could not exist if the territorial divisions were anything but exclusive; and that by restricting competition in the sale of Topco-brand goods, the association actually increases competition by enabling its members to compete successfully with larger regional and national chains.

The District Court, considering all these things relevant to its decision, agreed with Topco. It recognized that the panoply of restraints that Topco imposed on its members worked to prevent competition in Topco-brand products,[8] but concluded that

"[w]hatever anti-competitive effect these practices may have on competition in the sale of Topco pri-

[8] The District Court recognized that "[t]he government has introduced evidence indicating that some applications by Topco members to expand into territories assigned to other members have been denied," 319 F. Supp. 1031, 1042, but concluded that these decisions by Topco did not have an appreciable influence on the decision of members as to whether or not to expand. Topco expands on this conclusion in its brief by asserting that "the evidence is uncontradicted that a member has never failed to build a new store because it was unable to obtain a license." Brief for Appellee 18 n. 18. The problem with the conclusion of the District Court and the